

Iowa Credit Union Division

REGULATORY ADVISORY

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Guidance on Indirect Lending Programs

In an effort to boost loan volume and profitability, a growing number of Iowa state-chartered credit unions are engaging in Indirect Lending programs. Properly managed and administered, an indirect lending program can be beneficial in achieving these two goals. Based on data submitted in the December 31, 2004 call reports, of Iowa's 167 state-chartered credit unions, twenty-three or 13.8% are now engaging in this type of program. The total of the outstanding indirect loans is more than \$523 million. If the program is not administered and monitored properly, delinquency, vehicle repossessions, and ultimately loan charge offs can easily climb. If the charge offs become excessive, a material lessening of the credit union's net worth may result. Due to the increased activity in this area and the pitfalls that can occur, the Credit Union Division has reviewed and updated the guidance provided to its examiners to ensure it adequately explores pertinent issues and concerns involving indirect lending programs.

Indirect lending programs require special oversight and controls that differentiate them from the typical new or used auto programs. The credit union should have specific lending and collection policies for the indirect program. Some of the areas that the policies should cover include: staff approval and limitations; charge back and repossession guidelines; internal control structure; monitoring program; reports to management and the Board of Directors; and, all aspects of the collection process.

A large number of credit unions will underwrite the indirect loans using the same guidelines for underwriting their in-house loans. A credit union must have in place a strong internal control program that safeguards against dealers and contracts which may take advantage of members and the quality of the loans purchased. A rapid growth in these portfolios can cause quality issues – the strong internal control program must be in place prior to any loans being purchased.

A very important process credit unions need to perform is the monitoring of the indirect lending program. Failing to properly oversee the program is, or could become, a safety and soundness concern for regulatory officials. A lack of sufficient oversight demonstrates that management is not meeting its responsibilities to plan, direct and control the credit unions operations. Monthly management reports should include the following for each individual dealer:

- Applications submitted, approved, conditioned, and denied;
- Total loans outstanding;
- Delinquency;
- Extensions;
- First payment defaults;
- Repossessions;
- Charge-offs;
- Average loan to value;
- Average loan term;
- Average credit score.

Reports should be segregated by dealer to identify poor performing relationships. This will assist the credit union in determining the amount of dealer reserve(s) to maintain, which dealers are in non-compliance with agreements, and possibly which relationships should be terminated. These reports enable the credit union to determine the concentration of loans, which dealers are responsible for the highest percentage of approvals/denials, and which relationships are bringing the credit union business. The board must be kept abreast of the indirect lending programs performance to determine how it is impacting the credit unions financial condition. The materiality of the program to the credit unions operations and financial statements should dictate the frequency of reporting. For credit unions with new programs, rapidly growing portfolio or a portfolio that is a high percentage of Net Worth, monthly reports on the program are prudent.

The Division's examination staff will be more closely reviewing credit union indirect lending programs. To increase awareness and understanding of the Credit Union Division's approach to indirect lending, management is urged to review the National Credit Union Administration's Letter to Credit Union number 04-CU-13. Included in the letter are the questionnaires that examiners will be using to assess the credit unions indirect program. NCUA Letter 04-CU-13 and attached questionnaires can be referenced at www.ncua.gov/.